

CHASE

International Finance

Vol. XV, No. 17
September 1, 1980

Issued bi-weekly by the Economics Group of The Chase Manhattan Bank
for corporate customers and correspondent banks

Prospects Brighten for Earlier U.S. Recovery

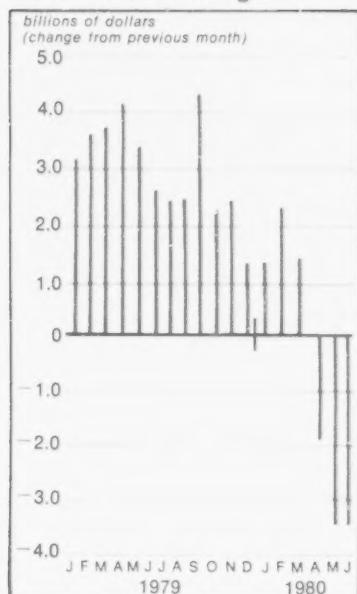
The economic recession in the United States is continuing. But the rate of decline is currently much slower—probably less than half the 9% annual rate of descent in real GNP that was recorded in the second quarter. Furthermore, there is now growing evidence of developments that could lead to an end to the recession in the reasonably near future.

The precipitous fall of interest rates in the late spring and early summer brought a rebound in construction of new housing in June and July. By May, starts on new housing units had fallen by more than 50% in just over a year. The more recent rebound of interest rates will prevent further improvement for a while, but the decline has been arrested. At the same time, consumer spending has improved in real terms after a very bad spring. Purchases of automobiles reached a low annual rate of 7.4 million units in May, 30% below the total for 1979. The rate of sales has since recovered about one-third of that loss. Consumer purchases of other goods have also begun to turn up modestly. And American consumers reduced their outstanding installment debt by record amounts—\$8½ billion in the second quarter of the year. That paydown of debt means that consumers will be better positioned to use new credit in support of a rising rate of spending in the future.

Perhaps most importantly, American business has already made progress in adjusting inventories to the new, lower rate of final demand. In real terms, inventories were cut in May and in June. Preliminary indications for July imply another reduction. Inventory corrections usually come late in a recession, when they tend to extend and deepen the economic decline. This unusually early start on inventory adjustment suggests that the current recession—while certainly a deep one—could be fairly brief. A growing number of forecasters now foresee an upturn beginning before the end of 1980.

The zero rate of increase in the Consumer Price Index in July was also a welcome development. Little recovery in consumer spending would be possible as long as the 15% rate of inflation of the first half of the year was sustained. However, while it is unlikely that prices will return to their former rate of increase, the mid-summer lull is clearly temporary. Food prices are already rising faster. And the demand weakness that moderated the upward trend of energy prices is likely to be temporary. Excluding the effect of such transitory developments, the United States still has an underlying inflation rate of 8%-10%, an uncomfortably high base from which to begin an economic recovery.

U.S. consumer
credit outstanding



U.K. Government remains committed to tight money policy, despite slip into recession.

Weakened German economy speaks for easier money stance, but DM concerns persist.

Canadian economic slowdown unfolding, but decline expected to be moderate.

Since its election in May 1979, the U.K. Government has sought to curb inflation with a restrictive monetary policy. But the policy has done little to stem the rise in earnings and prices, which are now climbing at some 21% and 17%, respectively. This has led firms to trim output and employment, and the economy is sliding into its worst recession since World War II, with a GDP decline of about 2% anticipated for the year. This situation has heightened tension between government and labor. The Government maintains that it will stick to its monetary policy, implying that labor will have to consent to lower wage settlements to preserve job security. Labor, however, is banking on the Government's backing off and boosting its money targets to accommodate large settlements. The situation has been clouded by the record 5% rise in the money supply in August. Much of the increase results from a change in reporting procedures and does not constitute an actual increase in credit supply. (It does indicate, however, that the old reporting procedures understated the size of the money stock, making the Government's money policy appear tighter than it really was.) Financial analysts now believe that if the Government seeks to remain firm, it will have to maintain tight money conditions longer than previously expected. They thus see little scope for interest rate reductions in the near future and expect to see sterling remain strong on the foreign-exchange markets.

Evidence is mounting that the German economy is in recession. Industrial production in the second quarter fell at a seasonally adjusted annual rate of 10.5%, compared with the first quarter, and the June figure was 1.6% below its year-earlier level. Industrial order volume also declined in the second quarter, and surveys show a marked deterioration in the business climate. Although import volume has been falling since February, unfavorable movements in Germany's terms of trade have widened the current-account deficit to DM 12.3 billion in the first half of 1980, versus DM 10 billion for all of 1979. These developments present the monetary authorities with a problem: Domestic considerations clearly point to a relaxation of monetary policy (the money stock is growing at the bottom end of its target range), but the large current-account gap has heightened concern that any reduction in interest rates will weaken the mark on foreign-exchange markets. Still, a slight relaxation has occurred, as DM 5.4 billion was made available to the money market in July for one month, which will be effectively replaced by the newly announced 10% cut in reserve requirements on banks' domestic and foreign liabilities. As the recession gathers steam, however, the authorities will be increasingly likely to take domestic economic considerations into account, and further interest rate declines are therefore probable.

The Canadian economy appears to be weakening, but there is little evidence that the overall output decline will be steep. Industrial production and real GDP have fallen in recent months, but the reductions have been moderate. Also, employment increased in June, and the July joblessness rate dropped to 7.6% from 7.8% in June. Inflation, on the other hand, rose to a rate of 10% in both June and July after running in single digits since the end of 1975. The reasons are higher costs for food, fuel, and housing. For some sectors of business, these higher costs are shrinking profit margins and pointing to a probable business recession for the year, and the housing and automobile sectors have already suffered large declines. Nonetheless, Canada's foreign trade surplus has held up surprisingly well, in light of the U.S. recession. And the future plans of business remain relatively optimistic, with spending surveys indicating a 21% increase in plant and equipment expenditures for the year. Together, these diverse and often conflicting trends suggest either a zero or a slightly negative real GNP growth rate for 1980, down significantly from the 1979 positive rate of 2.7%. Canadian inflation, however, is expected to remain in the 10% range, primarily the result of planned increases in the internal price of domestically produced oil.

High oil bills for Greece necessitate restrictive policies; inflation has still to respond.

Malaysian economic advance slows, but five-year-plan growth target may well be met.

Thailand's economy enjoying strong growth, but concern over inflation is high.

India tackles bottlenecks in efforts to spur industrial growth.

The 1979-1980 oil price rises are proving very costly for the Greek economy. Last year, Greece's oil bill rose by some \$800 million, and a further \$650-million rise to some \$2.5 billion is expected for 1980. Although the authorities tightened monetary and fiscal policies late last year, the country's current-account deficit—projected at over \$2.5 billion for 1980—will still exceed the \$2.3-billion gap of 1979. Tighter policies are expected to preclude any real economic growth this year, with public and private investment set to decline sharply. But inflation has yet to respond. During the first five months of 1980, consumer prices rose at an annual rate of 28%, which was 25% higher than their year-earlier level. In an attempt to sustain the competitiveness of Greek exports, the authorities devalued the drachma by about 14% over the first five months of the year, accepting the consequent rise in import prices. If competitiveness is to be maintained in the longer term, however, Greece must prevent the rise in import prices from being translated into higher labor costs.

The Malaysian economy experienced broad-based growth in 1979, posting real GNP growth of 5.5% and consumer price inflation of only 3.6%. Economic advance last year was driven by strong export earnings, firm demand for residential and commercial property, buoyant investment, and rapid increases in public spending. The economy is not expected to perform as well this year. The slowdown in world economic activity has dampened export growth and has temporarily curbed manufacturing investment. At the same time, the country's inflation rate has risen; it is now running at an unofficial rate of 8%-10%. The property market, however, continues strong, and government spending is offsetting some of the slack in other segments of the economy. In all, a 7% GNP growth rate is possible for 1980, sufficient to bring the growth performance for the third Malaysian plan period (1976-1980) very close to target.

The Thai economy advanced briskly in 1979, posting real GDP growth of 6.7%, down from the even stronger 11.7% pace of 1978. Despite the moderation in growth last year, inflation heated up and the balance of payments deteriorated. Consumer prices rose 9.9% in 1979, up from 7.6% in 1978, mainly the result of more costly oil imports, but also because of drought-related higher food prices late in the year. The country's trade deficit widened to \$2.3 billion in 1979 from \$1.4 billion in 1978, with the current-account gap widening to \$2.1 billion from \$1.2 billion. While the balance-of-payments performance has improved considerably in the first five months of this year, inflationary pressures have mounted. Through end-March, consumer prices had risen 7.3%, equivalent to an annual rate of over 20%. The Government responded by expanding the price controls introduced in 1979; still, the increase in prices for the month of May alone was 3.7%. The hope is that the favorable rains now under way will help ease food prices, while the stabilization of world oil prices will moderate oil import costs, leading to a decline in the inflation rate in the second half of the year.

India's real GNP declined by 3% in fiscal 1979/80 (ended March), the result of a drought-induced 10% fall in agricultural output and a 0.8% decline in industrial production. This year, abundant monsoon rains have improved prospects for agricultural production, provided that flooding does not inflict excessive damage. Industrial production, however, will remain constrained by shortages of coal and electric power and by inadequate transport. To alleviate these infrastructural bottlenecks, the Government has stepped up investment in electric power, coal, and steel and has eased import constraints somewhat to permit industry to obtain the needed inputs from abroad. In a further attempt to revitalize the industrial sector, the Government recently announced new fiscal incentives for industrial investment; it also moved to relax regulations that had restricted growth in private-sector productive capacity. While this more favorable attitude toward private enterprise offers hope for the future, infrastructural bottlenecks are likely to continue to constrain industrial growth in the near term.

Unemployment Looks Set to Rise

The unemployment rate remained steady at about 7% of the labor force in May, June, and July, after a steep run-up from 6.2% in March. The pause has allowed policymakers time to assess what stimulation, if any, the economy should receive. It has enabled the Administration to continue resisting a tax cut or massive employment program and has allowed the Federal Reserve to maintain a relatively steady posture, leaving interest rates to drift upward in response to monetary growth above short-run targets. But there are some indications that the unemployment rate may soon resume its rise—and precipitate calls for corrective government action.

The first indicators of potential deterioration are the employment statistics themselves. The Bureau of Labor Statistics publishes two measures of employment, one derived from a survey of households and one from a survey of (nonagricultural) employer payrolls. These measures may deviate from each other over the course of a few months, but they generally move in tandem over the longer term. Recently, the payroll indicator has shown steeper employment declines. From March to July, the payroll survey showed employment falling 1.4 million, while nonagricultural employment in the household survey declined only 800,000. Indeed, nonagricultural household employment rose 150,000 in

July, while the payroll survey showed employment down 240,000.

The household measure is used in formulating the unemployment rate because it is more comprehensive (it includes the self-employed), but the payroll measure is considered more accurate. For example, the larger decrease in employment through July revealed by the payroll survey is more consistent with the steep decline in industrial production and with the July decline in the wage and salary component of personal income in current dollars. Thus, if the employment decline revealed by the household survey were to match the decline in the payroll survey—which is likely to occur eventually—the unemployment rate could be expected to move at least one-half of a percentage point higher, even without any further growth in the labor force.

There are also strong economic reasons stemming from the interplay of labor supply and demand forces that speak for further increases in unemployment. Economic theory states that higher prices cause a fall in the quantity of a good demanded and an increase in the quantity supplied, all other conditions remaining the same. Applying the theory to the labor market, wages represent the price of labor, with the unemployment rate serving as a measure of the balance between the supply of and demand for labor.

During a period of high or rising unemployment, theory would allow that wages fall. However, in the current era of deeply embedded inflation, *money*, or nominal, wages cannot be expected actually to decline; at best, their growth rate might slow. The key variable is thus *real*, or inflation-adjusted wages. If the actual change in the general price level deviates from previous expectations, then the value of real wages either rises or falls. It is the real wage that guides the decisions of businesses as to how many workers to hire and determines whether potential workers actually seek employment, i.e., the forces of supply and demand. (Other factors, such as the overall level of economic activity, also influence demand for labor, while the supply is also affected by the existence of nonmarket alternatives, such as unemployment insurance.)

In the last period of rising unemployment (from early 1974 to mid-1975), the workers and employers responded to changes in real wages according to economic theory. In the first half of 1974, realized inflation exceeded expected inflation, thus lowering realized real wages. The resulting slower labor force growth, combined with the increase in labor demand, had the effect of holding the unemployment rate steady at about 5%, despite declining economic activity. But in the second half of the year, higher inflationary expectations led to sharply accelerated wage demands. The resulting real wage increases induced more people to seek employment. At the same time,

output slumped more sharply as businesses sought to trim inventories, further reducing the demand for the now-more-expensive workers. The unemployment rate then jumped sharply, reaching almost 9% by May 1975.

This pattern has repeated itself in the past eighteen months. In 1979, wage settlements remained steady while inflation accelerated, thus eroding real wages. The unemployment rate fluctuated in a narrow band just below 6%, as supply and demand for labor were roughly balanced. Wages and inflation both accelerated in early 1980 by about the same amount, and the unemployment rate edged up only slightly. But in the spring, wage settlements remained at their new higher level, while inflation abated sharply, bringing about a large increase in real wages. At the same time, output began slumping. The net effect of the reduced demand and increased supply was a sharp rise in unemployment.

General inflationary pressures are continuing to ease (excluding some food price rises attributable to drought-induced supply reductions). And additional cutbacks in production seem likely, as businesses strive to liquidate some of their unwanted inventories. Thus, if wage gains maintain their first-half pace, real wages would increase further, inducing additional increases in unemployment. At the same time, however, the increased slack in the labor market would act to moderate wage demands and lower the real wage, working to pave the way for a self-correcting return to lower unemployment.

Douglas L. Bendt

Latin America Bimonthly Survey of Business and Finance

COUNTRIES	CURRENT BUSINESS CONDITIONS	EXPORTS		GNP IN 1979		BALANCE OF PAYMENTS						MONEY AND BANKING							COUNTRIES
		3 months ending	change from year earlier	in billions of dollars	per capita	latest data	reserves (less gold) in million \$	12-month change	months of imports covered	use of IMF credit, mil- lions of dollars	current influences on payments	12-month changes			central bank rate		current monetary conditions		
												latest data	consumer prices	latest data	domestic credit	August 27, 1980		in U.S. dollars	
Argentina	New tax and tariff measures adopted to spur agri- cultural and industrial output and exports.	Mar.	+ 33%	102.1	\$3,825	Apr.	9,034	+ 42%	19.5	0	Foreign loan inflows being encouraged.	July	+ 100%	Mar.	+ 93%	—	.00050	Interest rates drifting down- ward.	Argentina
Bahamas	Tourist arrivals up 7% in first six months; inflation climbs to rate of 12%.	Mar.	+ 21%	1.1	4,590	June	100	— 6%	2.1	0	Restrictions placed on land purchases by foreigners.	Apr.	+ 12%	Mar.	+ 13%	—	.9800	Higher interest rates slow credit expansion.	Bahamas
Bolivia	World Bank approves \$50-million loan to assist in economic recovery and structural adjustment.	Mar.	+ 36%	4.7	930	June	144	— 19%	2.1	74	Negotiations to reschedule external debt of \$3.4 billion continue.	Apr.	+ 46%	Mar.	+ 51%	—	.0390	Net foreign assets show large declines.	Bolivia
Barbados	Economic activity slows from 1979 high, with weaker tourism and sugar harvest delays.	Mar.	+ 22%	0.5	2,000	June	69	— 16%	2.2	4	Import payments up, owing to higher prices.	Mar.	+ 19%	May	+ 25%	—	.5025	Demand for domestic credit in- creases.	Barbados
Brazil	Rate of inflation and wage increase tops 100%, but economic output rate slows.	Mar.	+ 32%	209.1	1,760	Mar.	6,915	— 31%	3.8	0	Reserves drop \$3 billion in first half of 1980.	July	+ 108%	Feb.	+ 79%	33.00%	.0178	Cruzeiro availability limited for nonfarm loans.	Brazil
Chile	Consumer prices up an annualized 30% in first seven months of 1980, versus 36% year ago.	Feb.	+ 70%	19.0	1,710	May	2,413	+ 50%	6.4	147	Jan.-Apr. copper exports up 11.5%; inter- national reserves hit \$2.4 bn. in May.	July	+ 36%	Dec.	+ 48%	—	.0260	Net foreign assets rising.	Chile
Colombia	New Plan of National Integration stresses public investment in communications and transportation.	Jan.	0	28.7	1,100	June	4,086	+ 29%	11.0	0	Rate of devaluation increased.	Apr.	+ 27%	Dec.	+ 11%	30.00%	.0220	Peso availability limited.	Colombia
Costa Rica	Record coffee crop anticipated; Government's joint venture with United Brands begins to show results.	Mar.	+ 15%	3.9	1,790	May	87	— 35%	0.7	72	Run on dollar in stock exchange prompts authorities to impose trading limits.	Apr.	+ 19%	Apr.	+ 39%	n.a.	.1172	Domestic liquidity tight.	Costa Rica
Dominican Rep.	New austerity program calls for freeze in government salaries and higher gasoline prices.	Mar.	+ 48%	5.3	1,000	June	166	— 24%	1.4	67	Payment for some capital equipment im- ports transferred to "parallel market."	Feb.	+ 21%	Feb.	+ 14%	—	Par	Credit policy is restrictive.	Dominican Rep.
Ecuador	Manufacturing advancing at a 12% annual rate, but agriculture and oil output growing more slowly.	May	+ 46%	8.7	1,070	June	905	+ 49%	5.4	0	Processed exports up sharply.	Apr.	+ 13%	Feb.	+ 43%	8.00%	.0370	Bank liquidity increasing.	Ecuador
El Salvador	Junta approves \$50-million investment plan to re- verse economic decline and check capital flight.	Dec.	+ 2%	5.4	760	June	78	— 73%	0.9	0	Coffee crop may drop by 25%, owing to poor weather and coffee rust.	June '79	+ 9%	May	+ 56%	—	.4015	Liquidity is tight.	El Salvador
Honduras	Government stepping up efforts to entice more companies for petroleum exploration.	Nov.	— 10%	1.9	540	Apr.	252	+ 21%	3.7	21	Higher prices for most principal exports should spur export growth.	Nov.	+ 14%	Apr.	+ 6%	4.00%	.4980	Rediscount lines increased by \$12.5 million.	Honduras
Mexico	Inflationary pressures mount; major labor union seeks 30% annual wage increase.	Mar.	+ 79%	117.9	1,700	Mar.	2,223	+ 10%	2.1	87	Severe drought necessitates increased food imports.	May	+ 25%	Dec.	+ 31%	—	.0400	Peso credit availability is limited.	Mexico
Panama	Expansion of Colon Free Zone under way, along with port and rail improvements.	Mar.	— 25%	2.7	1,420	June	193	— 4%	2.3	33	Crop losses cause drop in banana exports.	Mar.	+ 15%	Mar.	+ 21%	—	Par	Credit availability is generally satisfactory.	Panama
Paraguay	Inflation declines to 6.9% rate of increase in first six months; economic activity buoyant.	Feb.	+ 2%	3.7	1,225	June	685	+ 26%	15.0	0	Cotton and soybean price declines trim export earnings.	Apr.	+ 34%	Feb.	+ 24%	—	.007930	Monetary policy is restrictive.	Paraguay
Peru	Economy grew 3.2% in IQ, vs. 4.1% for all 1979; civilian president after 12 years military rule.	Mar.	+ 55%	12.1	700	Apr.	1,760	+ 362%	9.9	537	Trade balance posted a \$763-mn. surplus in first quarter, double year ago.	Mar.	+ 60%	Dec.	+ 16%	29.50%	.0035	Net international reserves con- tinue rising.	Peru
Uruguay	Real GDP grew 8.4% in 1979, up from 3.9% in 1978, mainly because of a tourist and construction boom.	Feb.	+ 15%	7.2	2,500	Apr.	457	— 18%	6.7	0	Tariffs to be reduced annually by 16%.	July	+ 71%	Mar.	+ 94%	—	.1105	Credit growth is rapid.	Uruguay
Venezuela	Country remains in recession; SIEX reorganized in effort to attract foreign investment.	Mar.	+ 50%	46.1	3,385	June	6,664	+ 29%	7.2	0	A \$1.8-bn. loan obtained, some of which will help restructure short-term debt.	May	+ 24%	Mar.	+ 3%	12.00%	.2300	Interest rate ceiling lowered further.	Venezuela

World Interest Rates

market rates of August 27, 1980; bond yields as of August 22, 1980

in percent per annum	U.S.	Canada	Britain	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan
Central Bank Discount Rate	10.00	10.45	16.00	12.00	9.50	7.50	15.00* penalty rate 18.00	9.00	3.00*	8.25
Day-to-Day Money	10.25 Aug. 28	10.50	16.00	11.00	11.0625	9.50	16.875*	10.125	5.00*	11.6875
Treasury Bills 91-day, Middle Rates	10.04	10.45	14.34	12.35	11.53 one-year	n. a.	15.35* 160-day	no dealing	no market	6.75
Commercial Paper prime, 3-month, asked	10.00 finance paper	10.60 finance paper 15% tax w/h	14.53	11.90 Certified	11.4375 Interbank	no market	no market	no market	no market	not traded
Bankers' Acceptances 3-month, asked	10.50	10.50 15% tax w/h	15.75	11.90 Certified	not traded	9.90	20.00*	no market	4.50*	no market
Government Bonds Long-term, new and old issues, average yield	11.13	12.80	13.37	10.86 20% tax w/h	12.58	7.74*	15.58*	9.73	4.58*	8.45
Industrial Bonds prime, long-term, new and old issues, average yield	12.20 Aa Industrials	13.375	13.85	14.34	13.83	7.82*	15.70*	10.25	5.615*	7.31
Bank Short-Term Rate to Best Borrowers (prime rate)	11.50	12.50	17.50	15.75	13.85	11.50	19.625*	12.00	5.75*	8.50
Bank Time Deposits 3-month	10.125 Cert. of Dep.	10.25 Cert. of Dep.	16.50	12.35	11.4375	8.75	10.75* large deposits	10.875 residents only	5.50* 20% tax w/h	6.00
Eurocurrencies 3-month, asked	12.00	no market	17.25	no market	12.375	8.8125	no market	10.875	6.3125*	no market
Exchange Rates—in U.S.\$ rates floating against the \$	—	.8558	2.3945	.0346	.2386	.5555	.001169	.5092	.6024	.004561
Forward Exchange Cover 3-month, in percent p.a. D = discount, P = premium	—	1.00 P	4.875 D	.75 D	.75 D	3.00 P	20.5 D	1.00 P	5.25 P	.25 D

Eurodollar Deposits

(London, interbank, bid)
Aug. 28

7-day	8.9375
1-month	10.125
3-month	11.6875
6-month	12.125

International Arbitrage

(3-month, hedged)

+ in favor of U.S. dollars

U.S.-U.K. Treasury Bills	+ .75
U.S.-Canada Treasury Bills	- 1.01
U.S.-Canada Finance Co. Paper	- 1.45
Eurodollars-U.K. Local Auth. Deposits	- .06

Eurobonds

(average yield on recent straight debt issues)

U.S. Dollar Bonds	
7 yrs. and under	11.875
Over 7 yrs.	12.25
DM Bonds	
7 yrs. and under	7.78
Over 7 yrs.	7.78

Gold Price

London
afternoon fixing
633.85
(per fine ounce)

The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short-Term Rate to Best Customers, while including customary commissions, reflect neither possible other fees nor varying compensating balance requirements.
* Rates as of Aug. 20, 1980; bond yields as of Aug. 15.

Current economic indicators of major industrial countries

	U.S.	Canada	Britain	France	Germany	Italy	Switzerland	Japan
Consumer prices*	13.2 (July)	10.1 (July)	16.9 (July)	13.5 (June)	5.5 (July)	21.6 (July)	3.3 (July)	8.4 (June)
Industrial production*	-9.2 (July)	-2.0 (June)	-6.7 (June)	0 (June)	-1.6 (June)	9.4 (June)	9.3 (Mar.)	5.8 (June)
Trade balance† (billions of local currency units)	-\$2.28 (June)	C\$0.89 (June)	£0.26 (July)	-FF5.39 (July)	DM0.28 (June)	-Lit.1,010 (June)	-SF0.99 (July)	¥28.3 (June)
Money supply (M₁)*	3.2 (July)	1.4 (June)	2.8 (May)	8.2 (Apr.)	1.6 (May)	20.6 (Mar.)	-11.7 (May)	1.9 (May)
Velocity of money* (M₁)*	2.7 (Mar.)	12.2 (Dec.)	4.8 (Sept.)	11.1 (Sept.)	4.1 (Dec.)	-0.2 (Sept.)	n. a.	3.8 (Dec.)
Reserves minus gold (\$ million, change from previous month)	130 (June)	83 (June)	188 (June)	85 (June)	1,366 (June)	-1,768 (June)	2,436 (June)	1,292 (June)

* Percent change from 12 months earlier.

† Figures are only for the month indicated.

Fashioning a U.S. Export Policy

The clarion call for a revitalized U.S. export policy appears now to have been muffled as the country's politicians pursue larger goals. Electioneering, the debate over tax cuts, and the broader issue of supply-side stimuli have taken center stage, pushing the export policy launched in September 1978 by the Carter Administration to the sidelines.

Several factors may be contributing to the Administration's apparent unwillingness to put teeth into export policy. First, there is a strong belief that if U.S. domestic economic problems are tackled within the context of a broader "reindustrialization" policy, exports and the balance of payments would strengthen as a consequence. And second, the U.S. balance of payments itself has improved. Although trade deficits have persisted (a trade shortfall of about \$31 billion is forecast for 1980, up slightly from the \$29.5-billion gap of 1979), the current account, which includes trade and services, has performed better. After recording a current-account deficit of \$10 billion, annualized, in the first quarter, the United States may have achieved a balance in the second quarter and may post a small surplus for 1980 as a whole. While some of the factors responsible for the improvement are cyclical—such as the weakened domestic economy and the resultant drop in import demand, especially for oil—others, specifically, rising services earnings, are likely to be more permanent. Nonetheless, there is concern that, depending upon economic conditions in Europe, the balance of payments could deteriorate sharply once the U.S. economic recovery gets under way.

The United States may well experience continued trade deficits and possibly large current-account shortfalls in the 1980s, despite the expectation of annual increases in export volume and services earnings. The reasons include the anticipation of extremely slow advances in productivity, continued high inflation, and unrelenting increases in oil import costs. These problems are compounded by the erosion of U.S. competitiveness stemming from its loss of a technological edge, the promotion and subsidization of exports by a growing number of advanced and developing countries, and the dollar's diminishing reserve role.

Thus, while it is vital to encourage the current interest in reindustrializing through productivity-enhancing tax cuts, stepped-up research and development, inflation control, and the reduction in energy dependence, there is also strong justification for a complementary export policy.

The most critical challenge in any policy of export promotion is the dismantling of the obstacles and bureaucratic impediments to exports. Such barriers have accumulated over years during which U.S. trade policy was neglected or subjugated to non-trade-re-

lated ends. The obstacles to U.S. exports run the gamut. They include:

- *Taxation of income earned by Americans working abroad.* The United States is the only industrialized nation to tax on the basis of citizenship rather than country of residence.
- *The Foreign Corrupt Practices Act.* This law, which bans bribery to obtain business contracts, discourages U.S. firms unsure of what conduct is illegal and how the law will be interpreted.
- *Webb-Pomerene Export Trade Act of 1918.* This law's ambiguous anti-trust provisions applicable to export trade associations have discouraged the formation of trading firms and associations.
- *Numerous restrictions on exports* stemming from national security, human rights, nuclear non-proliferation, and environmental impact concerns.

The export policy put forward by the Carter Administration in the fall of 1978 represented a limited acknowledgement of the need to boost the priority of exports. The program gave minimal attention to eliminating existing barriers or to creating significant new incentives, focusing instead on reorganizing government trade functions. It consolidated the Government's scattered trade responsibility in two key trade agencies: the U.S. Department of Commerce and the U.S. Trade Representative (USTR).

In addition to the reorganization, the Carter program called for:

- boosting Export-Import Bank direct lending and guarantee authority for fiscal 1980 to \$5.1 billion;
- allocation by the Small Business Administration of \$100 million of existing funds annually for export loan guarantees;
- \$20 million for export development programs of the Departments of State and Commerce;
- an effort to assess the "export consequences" of restrictions on exports to Communist countries;
- a commitment to work with Congress to devise better tax incentives for exports and lighten the tax burden on Americans working overseas;
- an easing of the requirement for environmental impact statements; and
- a call for the Justice Department to provide more expedient guidance on anti-trust matters.

In terms of new expenditures, the President's new policy provided little. But more important, it has been criticized for not making a serious effort to remove the obstacles to exports and provide new incentives.

As for the reorganization itself, it has been faulted for dividing authority between Commerce and the USTR by placing the USTR in charge of policy and

Fashioning a U.S. Export Policy *(continued from page 7)*

Commerce in charge of operations. Such a mechanism, argue critics, deprives the export cause of the strong, centralized leadership it needs. Proponents contend, however, that it more accurately reflects the pluralistic interest in trade that prevails within government and the political realities of bureaucratic consolidation.

With respect to the specific measures Mr. Carter called for in 1978, the results to date are mixed. Although Congress has recently approved raising the Export-Import Bank's combined loan and guarantee authority to \$5.1 billion for fiscal 1980 (which will end in just four weeks), little has been done to remove the wide range of restrictions on exports.

Supporters of the reorganization contend that it is still far too soon to pass judgment on the plan. A senior Commerce official insists that more has been accomplished than is realized but that substantial results will not show before 1981. He cautions, however, that the numerous impediments to exporting have strong constituencies and will be difficult to eliminate. At best, he feels, the old barriers will only be weakened somewhat, while the real emphasis will have to be on the creation of new incentives—an approach that would very likely compound the bureaucratic confusion for would-be exporters.

The Administration's next step will be to report to Congress on the wide range of incentives and disincentives for U.S. exports. The report—the release of which is imminent—will follow up a February 1980 statement on disincentives that skirted the most thorny issues and lacked specific proposals to boost exports. This time, the President is likely to announce more concrete action with respect to: easing the income tax burden on American workers overseas; clarification of uncertainties in the Foreign Corrupt Practices law; assuring the Export-Import Bank adequate and timely financing authority in the future; and modifying export licensing requirements.

Such efforts still fall short of the strong measures needed, but they do indicate the Administration's interest in sustaining the momentum. Interestingly enough, the strong support for export initiatives is coming from Congress—the body largely responsible for putting in place the existing export barriers.

There are currently a number of trade-related bills under consideration in Congress. Perhaps the most widely touted is Senator Adlai Stevenson's bill to promote the creation of export trading companies. By diversifying trade risks and developing economies of scale in marketing, financing, and related trade services, these intermediaries could have a significant impact by involving small and medium-sized firms in exporting. The bill also provides for a mechanism of certification and clearance from the anti-trust provi-

sions of Webb-Pomerene. Another bill seeks to clarify uncertainties in the Foreign Corrupt Practices Act, while the Senate Export Caucus' National Export Policy Act of 1980 would make the export expansion issue a national priority through wholesale revisions of existing laws and coordinated government programs and policies.

The need for a strong U.S. export policy now appears to be a well accepted notion in the United States. And this time the interest may endure. The rash of Congressional initiatives indicates a growing grass-roots support of export promotion. This raises the possibility of a greater integration of export policy into the economic and political decision-making process in Washington in the future. Moreover, the interest in exports has now been further institutionalized, with the reorganization having put in place what may prove to be a more effective mechanism for melding trade interests and eliciting presidential approval.

A key problem is getting the U.S. political and legislative system to respond to new initiatives in light of the overlapping jurisdictions both within Congress and still within the Administration. If the differing vested interests can be gradually overcome, and a consensus forged on new export incentives, legislation can be pushed through—or more importantly, old barriers removed.

Achieving a consensus within Congress and the Administration is only half the battle, however. Commitment to boosting exports must also show itself in the private sector. While there are signs that segments of the banking community are responding to the need for greater trade finance expertise, reorienting U.S. manufacturers to the international marketplace is perhaps the most formidable obstacle. American manufacturers must begin assessing the international competitiveness of their products and approach foreign marketing with greater sophistication by researching cultural and business patterns of foreign markets and through product adaptation. And they must be given the incentives to make the longer-term investments to permit profitable export operations in the future.

Another important challenge is the enlistment of the cooperation of labor in the export effort. The vital task in this regard is to focus labor's efforts on enhancing productivity and product quality and competitiveness. At the same time, U.S. officials must also act to neutralize *foreign-imposed* barriers to U.S. exports—including non-tariff barriers and other policies that have the effect of limiting access of U.S. goods to markets abroad—by effectively enforcing the new Tokyo Round codes. Only when serious action is taken on all these fronts will U.S. exports be competitive and have a fighting chance in world markets.

David M. Cheney